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## INTERNATIONAL DEVELOPMENT ASSOCIATION

REPORT AND RECOMMENDATION  
OF THE  
PRESIDENT  
TO THE  
EXECUTIVE DIRECTORS  
ON A  
PROPOSED CREDIT  
TO  
THE REPUBLIC OF KOREA  
FOR AN  
EDUCATION PROJECT

May 14, 1969

INTERNATIONAL DEVELOPMENT ASSOCIATION

REPORT AND RECOMMENDATION OF THE PRESIDENT  
TO THE EXECUTIVE DIRECTORS ON A PROPOSED  
CREDIT TO THE REPUBLIC OF KOREA FOR  
AN EDUCATION PROJECT

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1. I submit the following report and recommendation on a proposed credit in various currencies equivalent to \$14.8 million to the Republic of Korea for an education project.

PART I - HISTORICAL

2. In late 1967 an economic mission identified the need for increased emphasis on technical and vocational training in Korea's educational system. A Bank reconnaissance mission in March 1968 was followed by UNESCO project identification and preparation missions, which led to a request by the Government to IDA to help finance the improvement and expansion of the country's technical and vocational education facilities. The project was appraised in October/November 1968.

3. Progress in the industrial sector has outstripped the supply of trained manpower required to sustain the growth of the increasingly sophisticated industries, the mainstay of the country's rapid economic progress. The proposed project would help provide the skilled manpower needed for further economic expansion.

4. Negotiations for the proposed loan were held in Washington from April 14 to 17. Representing Korea were: Mr. S.C. Hong, Director, Bureau of Science Education, Ministry of Education; Mr. K.S. Choi, Counselor, Korean Embassy; Mr. I. Kang, Educational Attache, Korean Embassy; Mr. J.Y. Sun, Third Secretary, Korean Embassy.

5. The proposed credit would be the fourth to Korea. A proposed \$45 million Bank loan for irrigation will be presented to the Executive Directors on May 15. Before the end of this fiscal year, I expect to present for your approval a second Bank loan for the Korea Development Finance Corporation (KDFC) in an amount of \$20 million. A third railway project for which the Government has requested a Bank loan is currently being appraised.

6. The following is a summary statement of Bank loans and IDA credits to Korea as of April 30, 1969:

Loan or Credit No.	Year	Borrower	Purpose	Amount (U.S. \$ million)		
				Bank	IDA	Undisbursed
25	1962	Republic of Korea	Railway		13.9	Nil
110	1967	Republic of Korea	2nd Railway		11.0	1.0
529	1968	KDFC	Industry	5.0		4.7
S-4	1968	Republic of Korea	Highway			
			Studies	—	3.5	3.0
Total (less cancellations) now outstanding				<u>5.0</u>	<u>28.4</u>	—
Total undisbursed						<u>8.7</u>

7. The first railway project has been completed and the other projects are progressing satisfactorily. Disbursements are on schedule. IFC has invested \$700,000 in KDFC and is considering investments totalling \$6 million in equity and loans for two projects in Korea, a paper plant and a silk reeling plant.

#### PART II - DESCRIPTION OF THE PROPOSED CREDIT

8. Borrower: Republic of Korea
- Amount: Various currencies equivalent to \$14.8 million
- Purpose: To expand and improve technical and vocational education
- Amortization: In fifty years including a ten year grace period, through semi-annual installments beginning June 15, 1979 and ending December 15, 2018
- Service Charge: Three-fourths of one percent per annum

#### PART III - THE PROJECT

9. An appraisal report entitled "An Education Project in Korea" (PE-3a), dated May 14, 1969, is attached.

10. Korea's compulsory education system has produced a literacy rate of close to 90 percent, but turns out too many students not adequately trained to find a job after leaving school. Most schools badly lack commercial, scientific and engineering teaching equipment, and pupils completing technical courses are often unqualified to fill skilled manpower vacancies in commerce and industry. Steps to improve these schools and so increase the proportion of good quality graduates are urgently needed. The Government has drawn up an education plan to improve the system so as to relate the growth and quality of the output of the schools more closely to the overall economic needs of the

country. The rate of increase in the school age population is moderate, partly as a result of a vigorous family planning program, and this will make it possible for the Government to concentrate on the quality of schools rather than the quantity.

11. The project would not result in a substantially increased student enrollment, but is designed principally to improve the quality of existing education and training facilities. Its objective is to improve facilities in selected specialized schools where agricultural, commercial and technical subjects are taught in order to provide a substantial increase in suitably qualified manpower.

12. This, the first education project in Korea financed by the Bank Group, would provide for the expansion and equipment of twenty-seven technical high schools, five post secondary technical schools, and four university teacher training departments. It would also include twenty-six man-years of technical assistance, twenty man-years of overseas fellowships to support developments in agricultural and technical education and assist educational planning and the services of consultant architects.

13. To implement the proposed project a Project Unit would be set up at the Ministry of Education, headed by a Project Director, acceptable to the Association. It would include a qualified architect, a coordinator of the technical assistance teams and an experienced accountant. An overseas team of vocational teachers and educational planners would support the Project Unit. Furthermore, an overseas architectural firm acceptable to the Association with special experience in school building and school furniture, would be appointed to establish space, construction and costing standards applicable to all the schools in the project.

14. The total cost of the project is \$26.8 million. The proposed credit, covering 55 percent of the total cost, would finance all expenditures on equipment and furniture, 35 percent (the estimated foreign exchange component) of the civil works, and the foreign costs of consultants and fellowships. International competitive bidding would be used for the supply of all equipment and furniture, and for the construction of the schools. For furniture and equipment local suppliers will be allowed the usual preference of 15 percent or the prevailing customs duty, whichever is lower. As domestic contracting firms are competitive and well qualified, it is expected that construction work will be awarded to local contractors. Qualified local suppliers may win the contracts for furniture and some of the contracts for equipment, in which case about \$2 million of the credit would finance local currency expenditures.

15. Korea has made remarkable development efforts and its savings performance has increased considerably, being presently about 14 percent of GNP. But there is nevertheless a resource gap which cannot be met entirely by financing only the foreign exchange costs of projects suitable for Bank Group consideration. Many projects having a high

foreign exchange component, particularly in the industrial sector, are financed with private and official capital from abroad. In these circumstances, financing of some local expenditures on high priority projects is justified.

16. The proposed project is of high priority and is urgently needed if Korea is to have the skilled manpower needed for continued industrial development. The Ministry of Education, with the help of the consultants provided under the proposed credit, will be capable of efficient project implementation.

#### PART IV - LEGAL INSTRUMENTS AND AUTHORITY

17. The draft Development Credit Agreement between the Republic of Korea and the Association, the Recommendation of the Committee provided for in Article V, Section 1(d) of the Articles of Agreement and the text of a Resolution approving the proposed Credit are being distributed to the Executive Directors separately. The draft Development Credit Agreement generally follows the pattern of Development Credit Agreements for education projects.

#### PART V - THE ECONOMY

18. An economic report entitled "Current Economic Position and Prospects of the Republic of Korea" (EAP-4a) was circulated to the Executive Directors on March 19, 1969. The growth performance of the Korean economy continues to be outstanding. In spite of successive droughts GNP in real terms grew by 9 percent in 1967 and 13 percent in 1968. This is well above the plan target. The rate of population growth has slowed down from 3 percent to 2.3 percent in the last decade and per capita GNP was about US\$170 equivalent in 1968.

19. Agricultural performance in the last two years has been disappointing; 1968 output remained at the low level of 1967 which was 6 percent below 1966. While poor weather undoubtedly was the major reason, there was also a slowdown in land development and the use of current agricultural inputs. The Government is determined to speed up agricultural development.

20. Output in manufacturing rose by 23 percent in 1967 and almost 29 percent in 1968. Further industrialization is emphasized in the Government's development strategy. However, both agriculture and industry, besides bottlenecks in physical infrastructure, are faced with a shortage of skilled manpower.

21. Merchandise exports increased from an average level of less than US\$90 million in 1962-64 to US\$320 million in 1967 and to almost US\$490 million in 1968. However, especially in the last two years, imports grew even more than exports in absolute terms as a result of the economic expansion, trade liberalization, and large imports of foodgrains. The deficit on goods and services increased to almost

US\$680 million in 1968 from US\$415 million in 1967 and US\$220 million in 1964. Net foreign assets of the banking system amounting to US\$320 million at the end of February 1969 were equivalent to almost 3 months' imports.

22. Public savings rose substantially in the last three or four years owing to sharp increases in tax revenue, following a tax reform and continuing improvement of tax administration. Total gross domestic savings are expected to go up from 13 percent of GNP in 1968 to about 15 percent in 1969.

23. Since gross capital formation amounted to about 24.5 percent of GNP in 1968 the resource gap, which has been widening since 1966, reached close to 11.5 percent of GNP in 1968. It is expected to stay at about this percentage of GNP through 1971 but to increase in absolute amount. Gross investment is expected to reach a level of close to Won 500 billion (US\$1.8 billion) in 1969 or almost 26 percent of GNP. This would result in a resource gap of roughly US\$700-750 million to be financed by the inflow of capital from abroad.

24. During the last two years Korea has incurred a rather large amount of short- and medium-term debt. The debt service ratio is still modest but it increased from 2.6 percent in 1966 to 7.4 percent in 1968. If items now on order are delivered on schedule, service on public and private debt will reach 20 percent or more of exports of goods and services in 1970, not counting any provision for the service on new obligations. Korea cannot realistically expect to fill the estimated resource gap based on her present plans with borrowings on conventional and concessionary terms. Therefore the planned level of investments will have to be reconsidered to avoid an excessive debt burden. A possible slower growth of exports and decline of receipts from Vietnam may also accentuate the problem.

25. At the third meeting of the Consultative Group in Paris on April 17/18 the Korean Deputy Prime Minister assured the meeting of his Government's determination to control the inflow of short- and medium-term debt and to keep the debt service burden within reasonable limits. In its recent standby agreement with the Fund, the Korean Government agreed, for the current calendar year, to limit the contracting of new debt with maturities of between three and ten years to \$295 million and to limit new short-term credit with maturities between one and three years to the financing of essential grain and cotton imports of \$40 million. This represents a modest step towards reducing the disproportionate amount of debt on short- and medium-term. The Deputy Prime Minister also described other measures the Government is undertaking. All foreign loans are required to go through the Government's screening process, commercial banks are required to obtain clearance from the Ministry of Finance before they can guarantee foreign loans, and potential borrowers are required to obtain the Government's permission before they can start to negotiate with foreign suppliers. The Government intends to carry out a careful review of the investment

program, in particular large capital-intensive projects, to determine which of the projects can be postponed or scaled down. The Deputy Prime Minister also stated that export promotion will be strengthened further, that the export targets for 1969 to 1971 will be raised, and that the large repayments of short-term debts in 1970 and 1971 will be rescheduled so as to reduce the debt hump for these two years. He assured the members of the Consultative Group that the service of external debts with maturities of three years and over would not be allowed to exceed 15 percent of foreign exchange earnings. The Government also intends to slow down the increase of the money supply and keep price rises at the same or even lower rates than those in 1968: 6 percent increase in wholesale prices and 10 percent increase in consumer's prices.

26. During recent years, the Korean economy has grown rapidly, stimulated by a substantial inflow of capital, at the cost of incurring a considerable amount of short- and medium-term debt. The Government is now reviewing investment priorities, restricting foreign borrowing, and is actively promoting exports and discouraging imports by requiring advance deposits against letters of credit. In these circumstances and given the underlying strength of the economy, Korea can be regarded as creditworthy for the Bank lending at present planned. At the same time, Korea's per capita income is low, and considering that Korea will have to rely heavily on borrowing abroad for development, it would be both prudent and justified to provide part of the Bank Group's assistance on concessional terms.

#### PART VI - COMPLIANCE WITH ARTICLES OF AGREEMENT

27. I am satisfied that the proposed development credit would comply with the Articles of Agreement of the Association.

#### PART VII - RECOMMENDATION

28. I recommend that the Executive Directors approve the proposed development credit.

Attachment

Robert S. McNamara  
President  
by J. Burke Knapp

May 14, 1969